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November 13, 2007

Ms. Mary P. Levine
Acting General Counsel
Michigan State Housing Development Authority
735 E. Michigan Avenue
P.O. Box 30044
Lansing, MI 48912

RE: Comments on Proposed Changes to the QAP

Dear Ms. Levine:

MSHDA should certainly be commended for hearing comments from the development community, making many changes, and holding a second set of public hearings. It is a time consuming process, but one of great importance.

Below are the general comments I made at the November 13, 2007, public hearing in Detroit along with more detailed comments and questions that are too lengthy for a public hearing.

I. GENERAL COMMENTS

I would like to thank MSHDA for these additional hearings.

I have many detailed comments and questions that would take up too much time here, so I will leave a copy of those for staff.

My greatest concern is that numerous syndicators have indicated that Michigan is <u>not</u> an attractive investment market right now, and that some proposed changes to the QAP will make tax credit developments in Michigan even more unattractive. We can all ignore these warnings if we want. It may be easier to say that the overarching need for affordable housing and other social goals will force investors to make accommodations. <u>But they won't</u>. Investors have a myriad of alternatives from which to choose. A laudable social goal does not create an economically attractive market. We have to work to make it so.

I am NOT suggesting that we swing completely the other way, skip the supportive service end, Green Amenities, and just go for straight Section 42 housing and be done with it. I believe that we need to look at third, fourth, and fifth alternatives; analyze in more detail the affects of significant changes to the QAP; provide more resources to support non-housing goals; educate developers AND lenders AND syndicators to the benefits of practices such as Green Amenities; and be open to other ideas.

I will highlight 3 specific concerns here. They are:

A. 10% Supportive Service Requirement

Pro-forma vacancies in the <u>underwriting</u> <u>period</u> will increase due to the 60 day rule. Investors and lenders do not have a track record with this, so the amount of private funds that can be raised will decrease and/or reserve requirements will increase. This puts more of a demand on the need for public resources, or reduces the incentive for developers to take on a development.

B. Letters from Two Syndicators

There are so many factors that affect not only the price of tax credits, but the selection of a syndicator, that the two-letter requirement will, in the end, have no positive benefit.

C. Green Amenities Requirements

The cost in both dollars and extended time to develop a project is extremely hard to calculate right now. It appears that some mandatory requirements will eliminate projects in urban areas.

More time is needed to review and comment on these requirements. Perhaps it would be better to make all of the requirements optional with point scores for the first round in 2008, and then work clusters of these requirements in as mandatory over 3 or 4 funding rounds.

D. Thank you.

II. DETAILED COMMENTS AND QUESTIONS

A. Section VI – B: Allocation limits

Comment: Many potential Preservation developments have well in excess of 50 units and typically have 75, 100, 120 or even more units. The $750,000 credit limit is not enough to handle many of the potential Preservation projects. If the Authority allocates more than $750,000 in annual credits for Preservation projects on a case by case basis, it may perceived as using more subjective and less objective standards.

Recommendation: A higher limit of $950,000 for Preservation developments could alleviate some of this concern.

B. Section VIII-A-2: General Contractor Agreement

Question: Can MSHDA issue a draft of this agreement for comment? The developer, general contractor, lender(s), and syndicator will want to know the ramifications of this agreement before completing underwriting.

C. Section VIII-A-18: Two Equity Letters

Comment: If I understand the intent of this section correctly, MSHDA is attempting to ensure that the developer is obtaining the highest possible tax credit price for the particular development. This helps to ensure that public resources are being leveraged as much as possible. With two letters in hand, the assumption is either that tax credit prices can easily be compared, or that a fair analysis and comparison of all the terms, conditions, benefits, and risks of each syndication letter for every applicant can be completed within 60 to 90 days.

Below are some considerations and issues that might be needed in making any type of comparison.

1. Similar-sized developments can have different tax credit prices, even from the same syndicator, based on characteristics such as:
   a) Location of the development
   b) Experience of the Owner/Developer
   c) Target market
   d) Balance sheet(s) that support any guarantees
   e) Projected lease-up schedule
   f) AMI targeting levels
   g) Number of supportive services provided
   h) Type of hold-back
2. For one specific development, tax credit prices can differ based on:
   a) History, or lack thereof, of previous developments between a syndicator and sponsor or owner.
   b) Appetite of investor for developments in Michigan, or any particular submarket of the State.
   c) Pay-in schedule of capital contributions and/or developer fees.
   d) Different underwriting criteria that affect items such as amount of operating reserves, amount of contingency required, and debt service coverage.
   e) Amount of predevelopment funds, if any, that a syndicator has invested into the development BEFORE a tax credit application has been submitted, and/or BEFORE closing on equity.
   f) Amount, length, and type of guaranties required by the syndicator.

A developer's own self interest is to ensure, among other things, that the developer's fee is as high as reasonably possible, and as much as possible is actually paid out in the shortest time frame. These desires are balanced out against requirements of lenders and the syndicator that want less in developer's fees paid out, and want them paid out over a longer time frame. This provides additional comfort to the funders that the developer will finish and lease up the development according to schedule. It is in these types of negotiations that a balance is struck and a tax credit price set.

In order for a syndicator to issue a letter of *any* substance or meaning, it must go through an underwriting process similar to the Authority's. It is time consuming and detailed.

For developments that have received pre-development funding from one syndicator, the second syndicator knows that there is virtually no chance of actually investing in that particular project. Thus, it will not put forth the competitive effort that MSHDA wants. If a project is truly not under serious consideration by a syndicator, it will have to provide a false statement to the owner and to MSHDA; or, a developer that has received predevelopment funding from a syndicator will not be able to provide a second letter.

When MSHDA funds are invested directly into a development, the Authority requires that an experienced development team be formed up front. This is because a strong track record is a good indicator of experience and capacity that can be used in the current development. Similarly, because of the amount of money, complexity of a deal, number of requirements, and length of time that an Owner/Sponsor and investor will be together, the Owner wants an experienced syndicator.

The competitive effort for which the Authority is looking comes from work that the developer, sponsor, and/or development team members have done over the years to cultivate relationships with various syndicators. Given that there are so many syndicators throughout the United States and the tremendous regulatory authorities of the IRS and the SEC, the possibility of any collusive pricing is next to nil and should not be of concern. There is no monopoly on tax credit prices, so competition has already done its work.

RECOMMENDATION: Require a letter from just one syndicator. In order to determine if prices are competitive, perhaps the Authority would be better served to ask several syndicators, independent of the tax credit submission process, for a range of current tax credit prices broken down by categories similar to the Authority's hold-backs.

D. SECTION VIII-A-19: GREEN AMENITIES

COMMENT: Some requirements may be impossible to meet in urban or rural areas, or create other problems. For example:

1. In a rural area, 4 amenities within ¼ mile of a development is typically not part and parcel of the fabric of a rural community.
2. In a heavily-populated urban area, in the middle of an existing residential area, such amenities may be more than ¼ mile away, but still acceptable to those who live there.
3. All streets and sidewalks must be available for general public use (not gated): Does this mean, for example, only sidewalks that provide a route around a project to allow the flow of pedestrian traffic through a neighborhood; or does it mean public access to internal sidewalks that might lead to, say, a tot-lot?
4. Design surface parking to be accessed from rear façade, and not visible from public or private streets: In a densely populated urban area that has the ability to use existing streets and utility systems (one of the intents of the Green Amenities program), this may be impossible due to the density of the neighborhood.
5. **RECOMMENDATION**

a) For the first 2008 allocation rounds, make all Green Amenities criteria optional and put them in the Scoring Matrix.

b) For the second 2008 round and after additional comment from the housing community, start placing some items in as mandatory, and make more items mandatory each year. This will give the housing community time to adjust.

E. 10% Supportive Service Requirement

Comment: Tax credit investors are already leery about in investing in Michigan at all due to the economy. With FNMA and two other huge investors out of the market for the moment, there is less demand for credits. These two facts lead to falling tax credit prices for Michigan developments and stricter underwriting requirements.

We have found that many Special Needs tenants at or below 30% of AMI typically do not have enough income to pay even the 30% rents, let alone utilities. The rent usually does not even cover basic operating costs of the property.

Since both of the these forces are working on a development at the same time, *additional* underwriting risk has been created. This risk will reduce the appetite of investors even further. Without vouchers or some other kind of support, the 10% requirement adds additional financial risk to a development. The result of fewer investment dollars and more risk works against the goal of providing more supportive housing.

The unintended results are extremely difficult to determine right now, but I suspect that the initial results will look good for a year or two. Then, as reserves are used up, there will be more and more problems with properties not having enough money to fund social service needs, keep up maintenance, and the like. We have all seen the results of projects that practice what is euphemistically known as "deferred maintenance." This practice is just a symptom of a property that has at least one serious problem, or a series of problems, that compound upon themselves, and then create new problems. Once a development is on this downhill slide, it is extremely time-consuming and expensive to rescue it. I see a great potential for the same to happen with this 10% requirement **unless** more support is provided.

To be clear, we do support the push for supportive housing units. We are not asking for the 10% requirement to be removed. However, we want to make sure that the supportive units and the developments work in the long run. We believe that this requirement alone will ultimately work against its own intent.

Recommendation: We strongly recommend that project-based vouchers, HOME funds, or some other support mechanism be put in place along with this requirement.

1. Application Dates

   a) **Comment:** The January 2 Early Application period is for projects that target 100% of the units to Supportive Housing.

b) The April 1 date is for all other projects in the Supportive Housing holdback.

c) The tax credit submission date is April 1.

d) Therefore, there is no pre-review for developments with less than 100% Supportive Housing units. Given the demand for credits, this could eliminate all but 100% Supportive Housing developments.

e) Also, Section 4 on page III – 3 of the proposed Addendum III indicates that an MOU must be approved by a state interagency team However, if those developments with less than 100% Supportive Housing units cannot submit until April 1 and the tax credit deadline is April 1, it appears to prevent any Supportive Housing developments with less than 100% targeted units from even applying.

f) **RECOMMENDATION**: Open the Early Application process to all applicants in the Supportive Housing holdbacks.

F. SCORING

1. Section A-3: Community Revitalization

a) **QUESTION**: Is the maximum score 10 points here, or are any or all of the four (10, 5, 5, and 10) available?

2. Section B-2: Public Funding

a) **COMMENT**: By not allowing points for other public loan guaranty sources (such as HUD), MSHDA is forcing developers to rely more on MSHDA's already-stretched resources. Many non-MSHDA sources have been in use for years in the production of affordable housing. Since the tax credit program is being used to meet so many public purpose goals (affordable housing, housing for the homeless and other special needs clients, Green Amenities, creating quality employment opportunities, etc.), the Sponsor/Developers should be able to draw on as much funding from as many different resources as is needed.

b) **RECOMMENDATION**: Give equal scoring to all public funding sources and public loan guaranties.

Thank you again for the tremendous effort you and your staff have put forth in obtaining comments from the housing community, and in making many, many changes.

If you have any comments or questions, please do not hesitate to contact me.

Sincerely,

Owen W. Derry